

5 June 2013

Mr John Feil
Executive Director
National Competition Council
Level 21
200 Queen Street
MELBOURNE VIC 3000



Dear Mr Feil

Thank you for providing Envestra with the opportunity to comment on the four submissions received by the NCC on Envestra's application to have coverage revoked from the Wagga Wagga gas distribution network. Envestra puts forward the following comments:

- The submissions do not disturb the facts put forward by Envestra regarding the current and forecast competitive position of natural gas, which matters are key to criterion (a) no longer being satisfied. In particular, the submissions have remained silent on the competitive position of natural gas relative to electricity, along with the information regarding projected increases to wholesale gas prices, which increases will put gas (as a "fuel of choice") at a further competitive disadvantage and place significant constraints on future pricing. It is the competitive dynamics of the energy market in Wagga Wagga that will impose a greater constraint on natural gas distribution tariffs rather than regulation;
- The terms and conditions are currently regulated by the AER and reflect the outcome of a number of independent regulatory reviews and decisions made by the AER regarding the appropriate allocation of risk between Envestra and access seekers. The AER decision on fair and reasonable risk allocation has been factored into Envestra's network tariffs and also the charges recovered by retailers.

Envestra has proposed that the Wagga Wagga network will apply the most recent AER approved terms and conditions, which in this case is for our Albury network and is embodied in the Haulage Agreements with retailers in that market, as an appropriate starting point for negotiation. This approach is consistent with our intention to have nationally consistent terms and conditions across all of our networks. Given the use of this starting point, Envestra does not anticipate that there will be any major impediments to setting terms and conditions for Wagga Wagga if coverage is revoked.

It is worth noting that the dispute resolution procedures in the terms and conditions for Envestra's other unregulated networks have not once been triggered over the past 10 years;

- Aside from the proposal to apply the regulated Albury terms and conditions, we note that the negotiation of terms and conditions governing the supply of a service is commonplace. Envestra, Origin Energy, EnergyAustralia and AGL are all parties to a large number of commercially negotiated contracts, which in some cases are far more complex than the terms and conditions for the supply of natural gas distribution services in Wagga Wagga.
- Importantly, the submissions have not explained how changes to the terms and conditions, including by transferring risk from the retailers to Envestra, would impact competition in downstream markets. As explained in our application, Envestra has no incentive to discriminate between retailers, such that a level playing field between retailers will exist. The lack of incentive for Envestra to discriminate between retailers was not discussed in the submissions;
- In terms of the comments relating to appliance turnover, Envestra notes that this is an ongoing process that occurs when an appliance fails for an individual customer or is displaced by an electric equivalent more generally (as is the case with reverse cycle air-conditioning) and is a key contributor to the observed declining average consumption in Wagga Wagga (and across our other networks), which is related to the challenge of gas as a "fuel of choice" for customers. Envestra expects that the significant increases in wholesale gas prices over the next two years will prompt consumers to switch appliances earlier than they otherwise would (and will certainly impact the appliance choice in new homes);
- With regards to criterion (d), the submissions have suggested that over time regulatory costs should reduce due to prior learnings. This ignores actual evidence on recent review costs incurred by Envestra for South Australia, Queensland and Victoria as set out in table 9 of our application, which costs were incurred after around 10 similar regulatory review processes conducted by Envestra and the regulator prior to those most recent review processes. The key reason explaining why regulatory costs do not decline is the continual evolution of regulatory debate and changes in regulatory requirements/expectations over time (including through the AER Better Regulation program referred to in some of the submissions, which as explained in our application, is likely to further increase regulatory costs); and
- To this end, the Origin Energy example using a review process of 70 days ignores the evidence put forward in Envestra's application that distribution review processes are typically two year processes. Envestra also notes that it has proposed regulatory costs for Wagga Wagga that are 40% lower than the

recent South Australian, Queensland and Victorian review process due to the removal of all costs associated with developing an expenditure proposal along with the removal of legal and appeal costs (all of which assumptions are conservative based on past experience). Envestra also notes that Origin Energy has misinterpreted the labour component of review costs as being \$2.2 million whereas they are set out in table 10 of our application as \$1.5 million.

Critically, the submissions provide no factual evidence to support claims that criterion (a) is satisfied. The submissions have also not demonstrated how the supposed benefits under criterion (a) exceed the costs under criterion (d) as the submissions do not quantify the benefits under (a) or state what the regulatory costs should be.

Envestra would also like to clarify the following matters raised in the submissions:

- Page 1 of the Origin Energy submission points out that there is currently competition on the Wagga Wagga network, although Envestra notes that this competition is very limited. Envestra considers that the extent of retail competition is better summarised in the Energy Australia submission (page 3), who have noted that *"competition in the Wagga Wagga network over the past decade has not resulted in many gas retailers participating in the market."*
- Page 4 of Origin Energy's submission has compared the regulatory costs to what it considered to be the capital and operating expenditures for Wagga Wagga over a five year period. The costs referred to in the Origin Energy submission were in fact for the year 2011-12 only;
- Page 2 of Energy Australia's submission refers to requests by retailers as part of the recent Victorian Access Arrangement review process for Envestra to align its terms and conditions with the other two Victorian distributors. The reason this was not done, as accepted as being fair and reasonable by the AER, reflects that Envestra is a national distributor (unlike the other Victorian distributors) and is seeking to align its terms across all of its networks across Australia. Envestra considers that this approach is consistent with the basis for the new National Energy Customer Framework legislation;
- Page 3 of the Energy Australia submission does not explain how *"an uncovered network could further exasperate retail participation in Wagga Wagga"* given, as explained in our application, Envestra has no incentive to discriminate between retailers (such that there will be a level playing field for all retailers). This point was also made, but not explained, by Origin Energy on page 2 of its submission;
- Page 3 of the Energy Australia submission also suggests that it would not be economic for small retailers to undertake separate negotiations with Envestra in

order to enter the Wagga Wagga market. It is not clear why this would be the case. Envestra notes that any such retailer would need to also negotiate supply terms on the transmission network and for the purchase of gas from wholesalers. In any event, and as already noted, we anticipate offering retailers the terms and conditions consistent with that applying in the AER regulated Albury network; and

- Page 3 of Energy Australia's submission refers to pricing proposals being confidential. Envestra estimates, for example, that less than 1% of its Access Arrangement proposal for Victoria was confidential.

In terms of other (or miscellaneous) issues raised by the submissions, which are not of central importance to the NCC's consideration, Envestra notes that:

- The concerns raised over Envestra's ability to deliver on its future pricing strategy ignores the fact that such price outcomes have been delivered, on average, across Envestra's unregulated networks for over a decade (as set out in Envestra's application); and
- Envestra, as the owner of the Albury network, has no intention of seeking revocation of coverage of the Albury network (nor would such a matter impact on the merits of the case for Wagga Wagga in any event).

Envestra has not in this submission responded to all matters set out in the retailer submissions, but will do so, if required, in response to the NCC Draft Decision. Please feel free to contact either myself (08 8418 1129) or Peter Bucki (08 8418 1112) if you would like to discuss any matter raised in this submission further.

Yours Sincerely



Craig de Laine
Manager, Network Regulation